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June 14, 2004

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Enclosed is the report for the audit of the Food and Beverage Service Agreement for the Henry B. Gonzalez Convention Center. This audit was to determine if the RK Group Joint Venture complied with its contract. No one disputes that the RK Group of Companies has performed well for the City of San Antonio, and that their high quality innovative service has enhanced the City's offerings to convention and meeting Clients. Given the community's general knowledge and satisfaction with the services provided by the RK Group, including the Joint Venture, other areas of the contract were emphasized for evaluation and testing.

This engagement began in the spring of 2002 by establishing an objective for the audit, and by developing the scope and related planning activities. In early 2003, the audit team began to focus on the major issues and findings which included: security, minority partner participation, purchases from small/minority and/or woman owned businesses, equipment inventories, and recycling.

Work at the Convention Center by the RK Group Affiliate organizations surfaced as an area of interest that needed clarification. It became apparent that work performed off-site, that is away from the City's facility, by the RK Group Joint Venture Partners and/or its Affiliates also required clarification. After a February 2003 meeting with the Managing Venturer, additional documentation was provided, primarily Invoice History Reports for Catering by Rosemary, Inc. and Circa Texas, Inc. Preliminary analysis of this information occurred in spring 2003; and as a result, the audit was expanded. The objective was then to include comparing events at the Center with the commissionable sales revenue reported, and supporting records, to the City, and with the Invoice History Reports for the Managing Venturer, Catering by Rosemary, Inc., and for Circa Texas, Inc., an RK Group Affiliate.

While the audit was in progress in 2003, organizational changes occurred in City's Internal Audit Department and at the Convention Center. The audit was temporarily interrupted due partially to the staff transitions. Other audit work scheduled also contributed to this project being delayed until January 2004. In a series of conferences and meetings with City Management and Staff, the various contract compliance issues were discussed at length. This included the areas of work on-site that may not have been reported as referrals and of work off-site that may not have been reported as awarded without the specified competitive bidding processes.

The Facilities Director and his Staff worked with the Managing Venturer to answer and/or otherwise address the identified issues and findings. From January to early March 2004, more data was presented to either clarify or resolve the areas of interest involving the RK Group Joint Venture (JV). Most of this information was submitted to the Facilities Director who then summarized and/or added to the responses from the RK Group JV. Beginning in March 2004 and continuing through last week, the audit team began meeting directly with the Managing Venturer and when required with the JV Partners. The Managing Venturer, and its legal representative, reviewed finding drafts and the final draft report. They were also given opportunity to edit the RK Group Joint Venture responses shown in the attached final report.


Their position on several issues has been consistent. The RK Group Joint Venture believes that it has tried to comply, in good faith, with a contract that contains imprecise and unusual language. An agreement subject to substantial interpretation of key issues has been further complicated by requiring Client actions that the RK Group JV deemed as intrusive and unrealistic. A City imposed joint venture structure for this contract required the RK Group to make modifications to its established business policies and procedures. Based upon its understanding of the contract terms, the RK Group JV believes that it has paid the City the proper commission revenue. Dealings and practices, while not formalized as contract amendments, have been the method of operation since February 1997 for the RK Group JV. During the last year, it has recognized that formal documentation of various issues would be a better course. The RK Group Joint Venture has concerns about the proper resolution of several key areas, especially minority partner participation, Affiliate sales at the Center, off-site services by JV or Affiliates, and clarifying the application of the 19 percent service fee charged to Clients.

Auditors, in this and other engagements, must objectively report on the conditions that exist as compared with those expected per the contract. In this report, City Council is being given an analysis of how the vendor complied with the contract requirements. This evaluation has been substantially impacted by actions taken, or not taken as in this case, when the City developed the joint venture requirement for the request for proposal in 1996. It has also been complicated by acknowledged unresolved negotiations that lead to serious language compromises in the contract. The RK Group Joint Venture and City Staff should share responsibility and accountability for areas of noncompliance identified. While the audit team understands the RK Group JV's explanations for various findings, the data it provided has not been sufficiently adequate to revise the finding and recommendation for several critical issues.

It is recommended that the City seek to recover a claim from the RK Group Joint Venture for an estimate of unpaid commissions ranging from \$269,000 without interest, to \$503,600 including 18 percent interest. This represents the auditors' computation of one-half of potential commissions and related interest on the limited sample of transactions, 1997 to 2002, reviewed for Catering by Rosemary, Inc. and Circa Texas, Inc. The City Council will need advice from the City Attorney on a variety of legal issues surrounding this claim. While expanded/additional audit work may be another alternative to immediately pursuing the claim, the audit team suggests seeking a settlement resolution with the RK Group JV if possible. This would afford the knowledge gained by the audit being applied on the unresolved contract policy issues for the completion of this term, and for the potential five-year extension or for the new contract proposal process if required.

The Governance Committee instructed that this final report be distributed to the City Council in anticipation of an executive session on legal matters concerning this claim that may occur on June 24, 2004. Shortly, a draft report discussing the City's issues and findings related to the administration, operation and monitoring of this contract will be sent to the City Manager and Staff for their final review and responses.

Sincerely,



Patricia M. Major CPA, CTP, CGFM
City Internal Auditor

RK Group Joint Venture – 8 copies
Andrew Martin, City Attorney